

Research Update:

Danske Bank Outlook Revised To Stable On Increasing Loss Absorption Capacity; 'A/A-1' Ratings Affirmed

October 23, 2019

Overview

- We see reduced economic risk in Denmark, and Danske Bank's rapid issuance of loss-absorbing capacity (ALAC) provides an additional layer of protection to senior preferred creditors.
- We recognize that Danske Bank's unresolved money laundering-related investigations and lawsuits could still have negative consequences for the bank's capitalization and business profile.
- We are therefore revising our outlook on Danske Bank to stable from negative, and affirming our 'A/A-1' ratings.
- The stable outlook balances the risk of deterioration to Danske Bank's stand-alone credit quality due to the ongoing investigations and our expectation that the bank will maintain a very high ALAC and a robust capitalization over the next 24 months.

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Rating Action

On Oct. 23, 2019, S&P Global Ratings revised its outlooks to stable from negative on Denmark-based Danske Bank A/S and its core subsidiary Danica Pension Livsforsikringsaktieselskab (Danica). We affirmed our 'A/A-1' long- and short-term issuer credit ratings on Danske Bank and our 'A-' long-term rating on Danica.

Rationale

In our view, Danske Bank remains a strong pan-Nordic player, with a leading and resilient business position in Denmark. In addition, the bank benefits from robust capital generation via retained earnings. Furthermore, Danske Bank's loss-absorbing capacity has materially increased as a share of risk-weighted assets, reducing risks for senior bondholders. However, we also note

the historical deficiencies in corporate governance and anti-money-laundering procedures at the bank's Estonian branch between 2007 and 2015, as well as uncertainty regarding the ultimate impact of ongoing investigations on the bank's capitalization and business profile.

We now include a second notch of support in the rating to reflect Danske Bank's significant amount of ALAC--over 8% of its risk-weighted assets, as measured by S&P Global Ratings. This improvement stems from the bank's rapid build-up of MREL-eligible buffers and our assessment of lower economic risks in Denmark (see "Various Rating Actions Taken On Five Danish Banks As Denmark's Banking Market Offers Mixed Blessings," published Oct. 23, 2019, on RatingsDirect).

To fulfil its minimum requirement for own funds and eligible liabilities, Danske Bank is replacing large portions of maturing senior unsecured debt with senior nonpreferred instruments. In 2019 alone, the bank has issued more than Danish krone (DKK) 59 billion (about €7.9 billion), leading to a total issuance volume of about DKK85 billion by September 2019. We expect that Danske's future issuances will maintain its ALAC durably over 8% of risk-weighted assets.

Our view of lower economic risks in Denmark have led us to apply lower risk weights to assets located in the country in our risk-adjusted capital (RAC) analysis. This results in a higher RAC ratio for Danske Bank, and supports a moderate upside to our calculation of the bank's ALAC, thereby increasing the share of capital available to absorb potential losses. The bank's 2018 RAC ratio rises pro forma from 10.4% to 11.1%, and we expect it to remain close to 11.0% in the next 12-24 months. This has contributed to the bank's ALAC, since we include the excess capital above the 10% threshold qualifying for strong capital position in our ALAC calculation.

Despite having a stronger balance sheet, Danske Bank has attracted significant negative attention in Denmark and internationally since 2018. The bank's reputation was damaged by its alleged involvement in money-laundering activities in Estonia in 2007-2015. The bank's June 2019 announcement of having overcharged for its investment product, Flexinvest Fri, represented another reputational setback. However, Danske Bank's continued expansion in its core markets through 2018 and the first half of 2019 indicates that its business franchise has remained resilient. In addition, the bank's funding spreads have tightened after a sharp rise from July 2018, while the bank placed significant amounts of capital instruments over the period.

Despite these signals of stabilization, we continue to see vulnerabilities in Danske Bank's creditworthiness, prompting us to make a one-notch negative adjustment to the issuer credit rating on the bank. Danske Bank is currently discussing its Estonia case with authorities in the U.S., Denmark, Estonia, and France. The outcome of these regulatory investigations could further jeopardize the bank's business franchise, while fines and litigation costs could constrain the bank's capitalization.

Outlook

The stable outlook on Danske Bank incorporates a possible weakening in the bank's stand-alone credit quality due to the ongoing regulatory investigations. This could occur, for example, if the case incurs material damage to the bank's capitalization or franchise. The stable outlook also reflects our expectation that Danske Bank will maintain a very high ALAC and a robust capitalization in the next 24 months.

If we revise down the stand-alone credit profile, we would lower our issue ratings on the bank's senior nonpreferred debt and other hybrids.

We could downgrade the bank if the Estonia case eventually resulted in a serious and lasting consequences for both the bank's capitalization and its business franchise. While quite unlikely, we could also lower the rating if the Estonia investigation remained unresolved and we saw a

material weakening related to other factors, for example risk appetite, asset quality, or the impact of management changes on the bank's strategy formulation and delivery.

We could upgrade Danske Bank if we believed the bank's ongoing efforts to address historical control deficiencies were proving effective, we had greater clarity over the likely outcome of the regulatory investigations, with manageable regulatory penalties, and if the bank's franchise continues to show resilience. Together, these factors would align the bank's credit quality closer to that of 'A+' rated peers. However, the investigations will likely prolong, so we see little probability of an upgrade in the coming 12-24 months.

Our stable outlook on Danica reflects that on Danske Bank. This is because we regard it as a core subsidiary of the bank, and that it would receive support under all foreseeable circumstances if needed.

Ratings Score Snapshot

	To	From
Issuer Credit Rating	A/Stable/A-1	A/Negative/A-1
SACP	a-	a-
Anchor	bbb+	bbb+
Business Position	Strong (+1)	Strong (+1)
Capital & Earnings	Strong (+1)	Strong (+1)
Risk Position	Moderate (-1)	Moderate (-1)
Funding & Liquidity	Average & Adequate (0)	Average & Adequate (0)
Support	+2	+1
ALAC Support	+2	+1
GRE Support	0	0
Group Support	0	0
Sovereign Support	0	0
Additional Factors	-1	0

Related Criteria

- General Criteria: Group Rating Methodology, July 1, 2019
- General Criteria: Hybrid Capital: Methodology And Assumptions, July 1, 2019
- Criteria | Financial Institutions | General: Methodology For Assigning Financial Institution Resolution Counterparty Ratings, April 19, 2018
- Criteria | Financial Institutions | General: Risk-Adjusted Capital Framework Methodology, July 20, 2017
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- Criteria | Financial Institutions | Banks: Bank Rating Methodology And Assumptions: Additional Loss-Absorbing Capacity, April 27, 2015
- Criteria | Financial Institutions | Banks: Assessing Bank Branch Creditworthiness, Oct. 14, 2013

- Criteria | Financial Institutions | Banks: Quantitative Metrics For Rating Banks Globally: Methodology And Assumptions, July 17, 2013
- Criteria | Financial Institutions | Banks: Banks: Rating Methodology And Assumptions, Nov. 9, 2011
- Criteria | Financial Institutions | Banks: Banking Industry Country Risk Assessment Methodology And Assumptions, Nov. 9, 2011
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009
- Criteria | Financial Institutions | Banks: Commercial Paper I: Banks, March 23, 2004

Ratings List

Ratings Affirmed

Danica Pension Livsforsikringsaktieselskab

Subordinated	BBB
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Danske Bank A/S

Nordic Regional Scale	--/--/K-1
Certificate Of Deposit	A/A-1
Resolution Counterparty Rating	A+/-/-A-1
Senior Unsecured	A
Senior Subordinated	BBB+
Subordinated	BBB
Junior Subordinated	BB+
Commercial Paper	A
Commercial Paper	A-1

Ratings Affirmed; Outlook Action

	To	From
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Danica Pension Livsforsikringsaktieselskab

Issuer Credit Rating	A-/Stable/--	A-/Negative/--
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Danske Bank A/S

Danske Bank A/S, Swedish Branch

Issuer Credit Rating	A/Stable/A-1	A/Negative/A-1
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Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column. Alternatively, call one of the following S&P Global Ratings numbers: Client Support Europe (44) 20-7176-7176; London Press Office (44) 20-7176-3605; Paris (33) 1-4420-6708; Frankfurt (49) 69-33-999-225; Stockholm (46) 8-440-5914; or Moscow 7 (495) 783-4009.

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